No. 90-370

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

REPUBLIC NATIONAL BANK OF MIAMI,
Petitioner,

v.

FIDELITY & DEPOSIT COMPANY OF MARYLAND,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

MOTION OF THE AMERICAN BANKERS ASSOCIATION AND FLORIDA BANKERS ASSOCIATION FOR LEAVE TO FILE BRIEF AND BRIEF AS AMICI CURIAE IN SUPPORT OF THE PETITIONER

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MOTION OF THE AMERICAN BANKERS ASSOCIATION AND FLORIDA BANKERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE IN SUPPORT OF THE PETITIONER

Pursuant to the provisions of Rule 37.2 of the Rules of this Court, the American Bankers Association and Florida Bankers Association respectfully move for leave to file the attached Brief as Amici Curiae. The Petitioner has consented to the filing; the Respondent has declined to consent.

The American Bankers Association is the principal national trade association of the commercial banking

industry in the United States, having members in each of the fifty states and the District of Columbia. The Florida Bankers Association is the principal state trade association of the banking industry in Florida.

Issuing commercial letters of credit is a multi-billion dollar part of the business of commercial banks in Florida and throughout the United States. For letters of credit to serve their critical role in financing interstate and international transactions, they must be governed by well understood and uniformly applied rules. Letters of credit transactions cannot afford for variations, discrepancies, ambiguities and misunderstandings to creep into the law. Since the decision of the Eleventh Circuit below involves just such a misunderstanding of the practices in the letter of credit business, the two trade associations of the industry which relies upon those practices and understandings have an interest in seeing things set right.

WHEREFORE, the American Bankers Association and Florida Bankers Association respectfully request that the Court grant leave to file the attached brief as amici curiae in support of the petition for a writ of certiorari.

Respectfully submitted,

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QUESTIONS PRESENTED FOR REVIEW

1. Whether under Rule 3(c) of the Federal Rules of Appellate Procedure a supersedeas bond filed with a stipulation in which Appellant stated it was not then appealing constitutes a notice of appeal or its functional equivalent.

2. Whether a bank which issues a commercial letter of credit to finance the purpose of goods acts unreasonably, as a matter of law, in relying upon the documents of title and the underlying goods as collateral in the transaction.

3. Whether a standard bankers blanket bond—which provides coverage for loss resulting directly from the bank's having in good faith acquired, or given value, extended credit, or assumed liability, on the faith of, or otherwise acted upon, any original forged bill of lading—insures a bank against a loss sustained from honoring a letter of credit after presentation of original forged bills of lading held by the bank as collateral.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

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BRIEF OF THE AMERICAN BANKERS ASSOCIATION AND FLORIDA BANKERS ASSOCIATION AS AMICI CURIAE IN SUPPORT OF THE PETITIONER

The American Bankers Association and Florida Bankers Association, with leave of the Court, hereby respectfully submit this brief as amici curiae to urge the Court to grant the Petition for Writ of Certiorari in the above-entitled case.

INTEREST OF THE AMICI CURIAE

The American Bankers Association is the principal national trade association of the commercial banking

industry in the United States. It represents banks of all types and sizes—national and state-chartered, money center, regional and community banks, bank holding company-owned and independent banks. There are ABA member banks in each of the fifty states and the District of Columbia, and its member banks hold approximately ninety-five percent of the domestic assets of American banks.

The Florida Bankers Association is the primary representative, on the state level, of the commercial banking industry in Florida.

Issuing letters of credit is an important part of the banking business. Approximately $200 billion in credits are now outstanding in the United States.[1] Letters of credit have a special role in facilitating interstate and international multi-party transactions. The letter of credit device can only fill the role if all parties to any given transaction have a common understanding of the rules under which they are operating. In recognition of that need, the legislatures of the fifty states have enacted Article 5 of the Uniform Commercial Code, and the international business community, under the auspices of the International Chamber of Commerce, has promulgated and agreed to abide by the Uniform Customs & Practice for Documentary Credits.[2]

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[1] American Bar Association/U.S. Council on International Banking, *An Examination of U.C.C. Article 5 (Letters of Credit)* (1989) at xi.

[2] *See* J. Dolan, *The Law of Letters of Credit* (1984), ¶ 6.02: "Since 1962, all significant banking centers, with few exceptions, have adopted the Uniform Customs formally or informally and have thereby obviated the plethora of technical problems that could sabotage the smooth operation of documentary credits."

Paradoxically, while letters of credit need uniform and readily understood rules in order to operate effectively, the device is unfamiliar and little understood outside the branch of the banking industry (and the customers it serves) which specialize in this form of financing. Regrettably, the lack of understanding has resulted in the occasional judicial effort to analyze a letter of credit dispute by likening the documents at issue to other, more familiar, documents to which letters of credit bear some surface similarity. It does not work. It creates nothing but confusion, ambiguity and more litigation in a marketplace structure that can ill afford it. Your amici have a distinct interest in having order restored to this branch of our industry, and this case is a good starting point for the accomplishment of that end.

REASONS FOR GRANTING THE WRIT

We are well aware that Rule 10 of the Supreme Court Rules, "Considerations Governing Review on Writ of Certiorari," focuses upon questions of federal law. But the rule also provides, by its own terms, that it does not fully measure the Court's discretion. In this case, there is no federal statute or constitutional provision governing the general subject matter of letters of credit. Nevertheless, it is too facile a reaction to this case simply to dismiss it as a matter only of Florida law. It is much more than that. As indicated above, the law applicable to letters of credit is truly a combination of national (if not federal) law embodied in Article 5 of the Uniform Commercial Code and of private international law.[3] It is the intent

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[3] "The Uniform Customs are promulgated by the world's lead-

of the legislators of that law that it be uniformly interpreted and applied, and in order for that intent to be carried out, there must be a single, final judicial authority able and willing to serve in that capacity—this Court.

The dispute between the bank and the insurance company in this case is easy to articulate but hard to resolve. The bank purchased an insurance policy from F&D to protect itself against losses from forgeries, among other things. The bank issued a letter of credit in order to facilitate an international sale of coffee, taking original bills of lading as collateral for its commitment. After honoring the letter of credit, the bank discovered that the bills of lading were forged and that no coffee ever existed. The bank, therefore, lost over $1.2 million. If it was a loss due to forgery, the insurance company is obliged to recompense the bank under the policy. If it was a loan loss, it was not covered by the policy.

The Eleventh Circuit found that the loss was a loan loss. In arriving at that conclusion, however, the court exhibits a fundamental misunderstanding of how letters of credit work.

Letters of credit serve several functions. One function is as a method of payment. Another is as a method of financing akin to inventory financing, or

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ing commercial trade group (the ICC) and indorsed by the trade arm (UNCITRAL) of the largest international organization (the United Nations). Certainly, courts may identify weaknesses in the Uniform Customs or policies that conflict with those of the Uniform Customs. Absent those weaknesses or conflicting policies, the Uniform Customs provide courts with a thoughtful body of rules that they may elect to use." Dolan, *id.* at ¶ 4.06(1)(c).

asset based lending. Frequently it is a combination of both.

Where the letter of credit functions as a payment mechanism, the bank must be able to rely on the actual documents that are presented to it for payment. The bank is not a participant in the sale of goods. It has no responsibility for the underlying contract. U.C.C. § 5-109(1)(a); U.C.P. Art. 8. In a pure letter of credit situation the bank is a payment intermediary. In order for the letter of credit to be effective there must be as few uncertainties as possible when documents such as bills of lading are presented for payment.

Disputes over payment would make the letter of credit useless. As a result, the Uniform Commercial Code ("UCC") limits the responsibility of the bank to a determination of whether the payment documents are regular on their face. If they are, the bank pays. If they are not, the bank does not pay. The bank's responsibility, to see that the documents are regular on their face, is one that is within its control. Those things that are not within the bank's control—the quality of goods, performance of the contract, the genuineness of the documents—are matters for which the bank is not responsible.

The UCC does not make the issuer responsible for determining the genuineness of the documents. U.C.C. § 5-109(2). *See also* U.C.P. Art. 9. This is necessary to make letters of credit work. If the bank had the responsibility of determining if the documents were genuine, then it would have to engage in an investi-

gation beyond its role as payment intermediary.[4] This would create doubt about the reliability of the letter of credit as a method of payment and thus undercut its usefulness as a mechanism by which sellers of goods could be assured they would be paid without question or argument.

It is important to note that the beneficiary warrants the documents as well as the conditions of the credit. U.C.C. § 5-111(1) provides:

> (1) . . . [T]he beneficiary by transferring a documentary draft on demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with.

The beneficiary thus makes a statutory warranty to the bank upon which the bank is entitled to rely. The Eleventh Circuit's decision that the bank cannot rely on the genuineness of the documents directly deprives the bank of the warranty the law provides. The result is that banks will be reluctant to issue many letters of credit knowing that they could *only* rely on the credit of its customer and not on the warranties of the UCC.

In any commercial transaction there is always the possibility of forged or fraudulent documents. One

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[4] The duty of the bank is colorfully described in *Instituto Nacional v. Continental Illinois National Bank*, 675 F. Supp. 1515, 1520 (N.D. Ill. 1987). "There is no question the . . . bank . . . is not required to play detective. If it must act in a Holmesian manner at all, the nature of its duties draws more from Oliver Wendell than from Sherlock. [citing Kozolchyk, 8 Geo. Mason U. L. Rev. 287, 329]. It is obligated only to place the description of the documents called for in the letter of credit alongside the documents actually presented to see whether they jibe in facial terms."

way in which the bank deals with such risk is by relying on beneficiaries' warranties as well as by insurance. The bankers' blanket bond is a coverage for which banks pay substantial sums in order to protect themselves against just the risk that occurred in this case; that it was money paid based on documents that are forged. But for the forged documents, the bank would not have sustained the loss. The documents are the direct and consequential cause of the loss. Without the forged documents in the hands of the bank upon which it relied the loss never would have occurred.

In addition, the court below attempts to shift the cause of the loss from the fraudulent documents to the decision of the bank to issue the letter of credit at the request of its customer. This is not consistent with what occurs in actual commercial practice nor is it consistent with the Uniform Commercial Code or the Uniform Customs and Practice for Documentary Credits ("UCP").

The letter of credit serves not only as a mechanism for payment, but may also serve as a form of inventory financing. The bank, in agreeing to issue a letter of credit, may look to the value of the goods being purchased as collateral for issuance of and payment on the letter of credit. The bank's customer is frequently a purchaser of goods. A significant part of the decision to issue the letter may be based upon the availability of the goods as collateral for the payment which the bank makes to the seller. The bank *does* rely on the bill of lading. Without the collateral in the form of the goods represented by the bill of lading, the bank may well not have been willing to enter into the transaction initially.

The Eleventh Circuit's pronouncement that under accepted standards of commercial reasonableness a bank never relies on the documents presented for payment is simply not correct. The analysis that the bank only looks to the credit of its own customer is too narrow a view. It is no more true here than it would be for other kinds of financing. Obviously, banks assess the creditworthiness of a purchaser before making a real estate loan, but they also take back a mortgage on the property and rely upon the genuineness of the title documents in doing so. The same may be said for automobile and boat loans, inventory financing and so forth. If it were true that the bank could never look to the value of the goods as a factor in assessing the transaction, it would greatly restrict the bank's ability to issue letters of credit.

Banks have generally considered letters of credit to be a form of secured lending since the goods purchased serve as collateral should the bank's customer not repay the bank. The court below converts this aspect of the letter of credit into unsecured lending. Forcing the bank to rely solely on the credit of its customer reduces the amount of credit available and diminishes its usefulness in national and international trade.

The opinion below fails to analyze the nature of the letter of credit correctly when it concludes that the operative reliance occurs when the bank issues the letter of credit. This is the basis for the conclusion that, as a matter of law, the bank cannot be said to "rely" on the documents presented for payment.

The "establishment" of liability of the issuing bank is defined and governed by U.C.C. section 5-106. Es-

tablishment as to the customer occurs when the letter of credit is sent to him or to the beneficiary. As regards the beneficiary, it is established when received. Even though a letter of credit is "established," however, there are still contingencies that must occur before the bank pays value. Those conditions include the presentation of the letter of credit to the bank. The issuer's obligation to pay, and thus truly "extend credit," is wholly dependent on the beneficiary's performance. *Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 230 (5th Cir. 1983).

The court below is correct in assuming that a credit is extended to the beneficiary at the time the letter of credit is issued. However, this credit is basically inchoate and, until such time as payment is made on the letter of credit, it is merely "a commitment on the part of the issuing bank that it will pay a draft or demand for payment presented to it under the terms of the credit." *Bank of Newport v. First National Bank and Trust Company of Bismarck*, 687 F.2d 1257, 1261 (8th Cir. 1982). Since the banks' obligation to perform is simply a contingent liability, there is no giving of value by the bank under the terms of the bankers' blanket bond. The purpose of the bond is to insure against a fraudulently-induced payment. The bank neither extended credit nor gave value until the time it received physical possession of the forged documents *upon which it relied.*

Until the time that the conditions are met by the beneficiary, the obligation of the issuer to perform on its promise to pay the letter of credit is simply a contingent obligation. The letter of credit may never be exercised, it may expire of its own terms or the beneficiary may not present proper documents trig-

gering the contingency. In fact, in the leading case in Florida regarding an issuer's duties with regard to honoring a letter of credit the District Court of Appeals stated, "[A] letter of credit amounts to an offer by the issuer to purchase certain documents. If those documents are not tendered, the offer is not accepted, and issuer is not bound." *Fidelity National Bank of South Miami v. Dade County*, 371 So. 2d 545, 548 (Fla. App. 1979).

The court below treats issuance of the letter of credit exclusively as an extension of credit—a loan—to the bank's customer based *only* on the customer's credit and without reference to the goods being acquired. This is simply not correct. While the letter of credit transaction may involve a loan, this is by no means necessarily the case. For example, a bank may issue a letter of credit only when it is actually holding funds of its customer. When the documents are presented, the bank pays with the funds of the customer that it has on hand and no loan is ever made. Conversely the bank may simply lend its credibility by issuing a letter of credit but may never give actual value if the beneficiary chooses not to comply or submit noncomplying documents.

The issuance of the letter of credit is clearly not a loan. It is approval to make a payment based on future contingencies. The bank's agreement is that for the time specified it will pay the amount of the letter of credit *if* and when documents regular on their face are presented.

Of course, the letter of credit may be used in conjunction with a loan to the bank's customer as was the case here. When that occurs the extension of credit comes *after* the letter of credit is honored. At

that point rather than reimburse the bank immediately, the customer then becomes a borrower, promising to pay the funds advanced for its benefit over time. This is a loan and interest is charged at the negotiated rate. The charge for issuing the letter of credit is a flat fee payable regardless of when, if ever, the beneficiary draws upon the letter of credit. If it does, and then if a loan is made in conjunction with it, an extension of credit will have been made.

From the foregoing it should be clear that neither as a matter of law or commercial practice is the decision to issue the letter of credit an irrevocable commitment to extend credit to the customer. By focusing on the extension of the credit aspect of a letter of credit transaction the court below erroneously concludes that the only meaningful reliance is on the credit of a bank's customer. But in fact the bank is entitled to rely, and must rely, on the documents that are presented to it. It may rely on the goods involved in the transaction as security in its decision to issue the letter and in many cases no extension of credit at all will be involved.

The fact is that banks do rely in two crucial respects on the genuineness of the documents presented. The first is to trigger the payment of funds pursuant to the existing contract with the customer and the second is to provide the bank with collateral in the case where the letter of credit is used in conjunction with a loan to the customer.

CONCLUSION

The Eleventh Circuit decision in this case greatly misconstrues commercial practice and uniform law in the area of letters of credit. It is part and parcel of

a disturbing trend in the courts to do precisely that,[5] chipping away at the very foundation of this important device in interstate and international commerce. It is a trend which needs to be reversed. Since trends can only be addressed by addressing cases, we respectfully urge the Court to address this one by granting the Petition for Writ of Certiorari.

Respectfully submitted,

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[5] *See, e.g., Exxon Co. USA v. Banque de Paris et des Pays Bas*, 889 F.2d 674 (5th Cir. 1989), *cert. denied*, ___ U.S. ___ (1990) (allowing beneficiary to recover under a letter of credit in disregard of explicit expiry date); *Federal Deposit Insurance Corp. v. Bank of Boulder*, ___ F.2d ___ (10th Cir. 1990) (allowing transferee of original beneficiary of letter of credit to recover in disregard of statutory limitation on transferability).